matched to the new hedged item, items, or aggregate risk under the principles of paragraph (b) of this section.

(8) *Unfulfilled anticipatory transactions*—(i) *In general.* If a taxpayer enters into a hedging transaction to reduce risk with respect to an anticipated asset acquisition, debt issuance, or obligation, and the anticipated transaction is not consummated, any income, deduction, gain, or loss from the hedging transaction is taken into account when realized.

(ii) *Consummation of anticipated transaction.* A taxpayer consummates a transaction for purposes of paragraph (e)(8)(i) of this section upon the occurrence (within a reasonable interval around the expected time of the anticipated transaction) of either the anticipated transaction or a different but similar transaction for which the hedge serves to reasonably reduce risk.

(9) *Hedging by members of a consolidated group*—(i) *General rule: single-entity approach.* In general, a member of a consolidated group must account for its hedging transactions as if all of the members were separate divisions of a single corporation. Thus, the timing of the income, deduction, gain, or loss on a hedging transaction must match the timing of income, deduction, gain, or loss from the item or items being hedged. Because all of the members are treated as if they were divisions of a single corporation, intercompany transactions are neither hedging transactions nor hedged items for these purposes.

(ii) *Separate-entity election.* If a consolidated group makes an election under §1.1221–2(e)(2), then paragraph (e)(9)(i) of this section does not apply. Thus, in that case, each member of the consolidated group must account for its hedging transactions in a manner that meets the requirements of paragraph (b) of this section. For example, the income, deduction, gain, or loss from intercompany hedging transactions (as defined in §1.1221–2(e)(2)(ii)) is taken into account under the timing rules of §1.446–4 rather than under the timing rules of §1.1502–13.

(iii) *Definitions.* For definitions of consolidated group, divisions of a single corporation, intercompany transaction, and member, see section 1502 and the regulations thereunder.

(iv) *Effective date.* This paragraph (e)(9) applies to transactions entered into on or after March 8, 1996.

(f) *Type or character of income and deduction.* The rules of this section govern the timing of income, deduction, gain, or loss on hedging transactions but do not affect the type or character of income, deduction, gain, or loss produced by the transaction. Thus, for example, the rules of paragraph (e)(3) of this section do not affect the computation of cost of goods sold or sales proceeds for a taxpayer that hedges inventory purchases or sales. Similarly, the rules of paragraph (e)(4) of this section do not increase or decrease the interest income or expense of a taxpayer that hedges a debt instrument or a liability.

(g) *Effective date.* This section applies to hedging transactions entered into on or after October 1, 1994.

(h) *Consent to change methods of accounting.* The Commissioner grants consent for a taxpayer to change its methods of accounting for transactions that are entered into on or after October 1, 1994, and that are described in paragraph (a) of this section. This consent is granted only for changes for the taxable year containing October 1, 1994. The taxpayer must describe its new methods of accounting in a statement that is included in its Federal income tax return for that taxable year.

[T.D. 8554, 59 FR 36358, July 18, 1994, as amended by T.D. 8653, 61 FR 519, Jan. 8, 1996; T.D. 8674, 61 FR 30138, June 14, 1996; T.D. 8985, 67 FR 12865, Mar. 20, 2002; 67 FR 31955, May 13, 2002]

§1.448–1 Limitation on the use of the cash receipts and disbursements method of accounting.

(a)–(f) [Reserved]

(g) *Treatment of accounting method change and timing rules for section 481(a) adjustment*—(1) *Treatment of change in accounting method.* Notwithstanding any other procedure published prior to January 7, 1991, concerning changes from the cash method, any taxpayer to whom section 448 applies must change its method of accounting in accordance with the provisions of this paragraph (g) and paragraph (h) of this section. In the case of any taxpayer required by

this section to change its method of accounting for any taxable year, the change shall be treated as a change initiated by the taxpayer. The adjustments required under section 481(a) with respect to the change in method of accounting of such a taxpayer shall not be reduced by amounts attributable to taxable years preceding the Internal Revenue Code of 1954. Paragraph (h)(2) of this section provides procedures under which a taxpayer may change to an overall accrual method of accounting for the first taxable year the taxpayer is subject to this section (''first section 448 year''). If the taxpayer complies with the provisions of paragraph (h)(2) of this section for its first section 448 year, the change shall be treated as made with the consent of the Commissioner. Paragraph (h)(3) of this section provides procedures under which a taxpayer may change to other than an overall accrual method of accounting for its first section 448 year. Unless the taxpayer complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year, the taxpayer must comply with the provisions of paragraph (h)(4) of this section. See paragraph (h) of this section for rules to effect a change in method of accounting.

(2) *Timing rules for section 481(a) adjustment*—(i) *In general.* Except as otherwise provided in paragraphs (g)(2)(ii) and (g)(3) of this section, a taxpayer required by this section to change from the cash method must take the section 481(a) adjustment into account ratably (beginning with the year of change) over the shorter of—

(A) The number of taxable years the taxpayer used the cash method, or

(B) 4 taxable years,

provided the taxpayer complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year.

(ii) *Hospital timing rules*—(A) *In general.* In the case of a hospital that is required by this section to change from the cash method, the section 481(a) adjustment shall be taken into account ratably (beginning with the year of change) over 10 years, provided the taxpayer complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year.

(B) *Definition of hospital.* For purposes of paragraph (g) of this section, a hospital is an institution—

(*1*) Accredited by the Joint Commission on Accreditation of Healthcare Organizations or its predecessor (the JCAHO) (or accredited or approved by a program of the qualified governmental unit in which such institution is located if the Secretary of Health and Human Services has found that the accreditation or comparable approval standards of such qualified governmental unit are essentially equivalent to those of the JCAHO);

(*2*) Used primarily to provide, by or under the supervision of physicians, to inpatients diagnostic services and therapeutic services for medical diagnosis, treatment, and care of injured, disabled, or sick persons;

(*3*) Requiring every patient to be under the care and supervision of a physician; and

(*4*) Providing 24-hour nursing services rendered or supervised by a registered professional nurse and having a licensed practical nurse or registered nurse on duty at all times.

For purposes of this section, an entity need not be owned by or on behalf of a governmental unit or by a section 501(c)(3) organization, or operated by a section 501(c)(3) organization, in order to be considered a hospital. In addition, for purposes of this section, a hospital does not include a rest or nursing home, continuing care facility, daycare center, medical school facility, research laboratory, or ambulatory care facility.

(C) *Dual function facilities.* With respect to any taxpayer whose operations consist both of a hospital, and other facilities not qualifying as a hospital, the portion of the adjustment required by section 481(a) that is attributable to the hospital shall be taken into account in accordance with the rules of paragraph (g)(2) of this section relating to hospitals. The portion of the adjustment required by section 481(a) that is not attributable to the hospital shall be taken into account in accordance with the rules of paragraph (g)(2) of this section not relating to hospitals.

(iii) *Untimely change in method of accounting to comply with this section.* Unless a taxpayer (including a hospital and a cooperative) required by this section to change from the cash method complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year within the time prescribed by those paragraphs, the taxpayer must take the section 481 (a) adjustment into account under the provisions of any applicable administrative procedure that is prescribed by the Commissioner after January 7, 1991, specifically for purposes of complying with this section. Absent such an administrative procedure, a taxpayer must request a change under §1.446–1(e)(3) and shall be subject to any terms and conditions (including the year of change) as may be imposed by the Commissioner.

(3) *Special timing rules for section 481(a) adjustment*—(i) *One-third rule.* If, during the period the section 481(a) adjustment is to be taken into account, the balance of the taxpayer's accounts receivable as of the last day of each of two consecutive taxable years is less than 66⅔ percent of the taxpayer's accounts receivable balance at the beginning of the first year of the section 481(a) adjustment, the balance of the section 481(a) adjustment (relating to accounts receivable) not previously taken into account shall be included in income in the second taxable year. This paragraph (g)(3)(i) shall not apply to any hospital (within the meaning of paragraph (g)(2)(ii) of this section).

(ii) *Cooperatives.* Notwithstanding paragraph (g)(2)(i) of this section, in the case of a cooperative (within the meaning of section 1381(a)) that is required by this section to change from the cash method, the entire section 481(a) adjustment may, at the cooperative's option, be taken into account in the year of change, provided the cooperative complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year.

(iii) *Cessation of trade or business.* If the taxpayer ceases to engage in the trade or business to which the section 481(a) adjustment relates, or if the taxpayer operating the trade or business terminates existence, and such cessation or termination occurs prior to the expiration of the adjustment period described in paragraph (g)(2) (i) or (ii) of this section, the taxpayer must take into account, in the taxable year of such cessation or termination, the balance of the adjustment not previously taken into account in computing taxable income. For purposes of this paragraph (g)(3)(iii), the determination as to whether a taxpayer has ceased to engage in the trade or business to which the section 481(a) adjustment relates, or has terminated its existence, is to be made under the principles of §1.446–1(e)(3)(ii) and its underlying administrative procedures.

(iv) *De minimis rule for a taxpayer other than a cooperative.* Notwithstanding paragraph (g)(2)(i) and (ii) of this section, a taxpayer other than a cooperative (within the meaning of section 1381(a)) that is required to change from the cash method by this section may elect to use, in lieu of the adjustment period described in paragraph (g)(2)(i) and (ii) of this section, the adjustment period for de minimis section 481(a) adjustments provided in the applicable administrative procedure issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's consent to a change in accounting method. A taxpayer may make an election under this paragraph (g)(3)(iv) only if—

(A) The taxpayer's entire net section 481(a) adjustment (whether positive or negative) is a de minimis amount as determined under the applicable administrative procedure issued under §1.446–1(e)(3)(ii) for obtaining the Commissioner's consent to a change in accounting method,

(B) The taxpayer complies with the provisions of paragraph (h)(2) or (3) of this section for its first section 448 year,

(C) The return for such year is due (determined with regard to extensions) after December 27, 1993, and

(D) The taxpayer complies with any applicable instructions to Form 3115 that specify the manner of electing the adjustment period for de minimis section 481(a) adjustments.

(4) *Additional rules relating to section 481(a) adjustment.* In addition to the rules set forth in paragraph (g) (2) and (3) of this section, the following rules

shall apply in taking the section 481(a) adjustment into account—

(i) Any net operating loss and tax credit carryforwards will be allowed to offset any positive section 481(a) adjustment,

(ii) Any net operating loss arising in the year of change or in any subsequent year that is attributable to a negative section 481(a) adjustment may be carried back to earlier taxable years in accordance with section 172, and

(iii) For purposes of determining estimated income tax payments under sections 6654 and 6655, the section 481(a) adjustment will be recognized in taxable income ratably throughout a taxable year.

(5) *Outstanding section 481(a) adjustment from previous change in method of accounting.* If a taxpayer changed its method of accounting to the cash method for a taxable year prior to the year the taxpayer was required by this section to change from the cash method (the section 448 year), any section 481(a) adjustment from such prior change in method of accounting that is outstanding as of the section 448 year shall be taken into account in accordance with the provisions of this paragraph (g)(5). A taxpayer shall account for any remaining portion of the prior section 481(a) adjustment outstanding as of the section 448 year by continuing to take such remaining portion into account under the provisions and conditions of the prior change in method of accounting, or, at the taxpayer's option, combining or netting the remaining portion of the prior section 481(a) adjustment with the section 481(a) adjustment required under this section, and taking into account under the provisions of this section the resulting net amount of the adjustment. Any taxpayer choosing to combine or net the section 481(a) adjustments as described in the preceding sentence shall indicate such choice on the Form 3115 required to be filed by such taxpayer under the provisions of paragraph (h) of this section.

(6) *Examples.* The following examples illustrate the provisions of paragraph (g) of this section.

Example (1). Y is required by this section to change from the cash method of accounting for its taxable year beginning January 1, 1987. Y changes to an overall accrual method. The adjustment required by section 481(a) to effect the change is $10,000. Y has been using the cash method for the 10-year period preceding the year of change. Y is required by paragraph (g)(2)(i) of this section to include the section 481(a) adjustment in taxable income ratably over four consecutive taxable years, beginning with 1987, i.e., $2,500 of the section 481(a) adjustment should be included in income for each of the four years.

Example (2). The facts are the same as in example (1), except that Y is required to change from the cash method and changes to an overall accrual method of accounting for its taxable year beginning January 1, 1989. The result is the same as in example (1), except that the four-year period for ratably taking the section 481(a) adjustment into account begins with the 1989 taxable year.

Example (3). Assume that X is required by this section to change from the cash method and that it changes to an overall accrual method for its taxable year beginning January 1, 1987. The adjustment required by section 481 (a) to effect the change is $10,000. X was formed on January 1, 1986, and began business operations during that year. Since X only used the cash method for one year, X is required by paragraph (g)(2)(i) of this section to include all ($10,000) of the section 481(a) adjustment in taxable income for the 1987 taxable year.

Example (4). The facts are the same as in example (1). In addition, Y previously changed from an accrual method of accounting to the cash method for its taxable year beginning January 1, 1983. As a result of that prior change, Y was required to take into account a $5,000 negative section 481(a) adjustment ratably over a ten-year period, beginning with the 1983 taxable year.

As of the beginning of the 1987 taxable year $3,000 of that adjustment had not been taken into account. Y may continue to take the remaining negative $3,000 section 481(a) adjustment into account ratably over the remaining adjustment period for the prior change in method of accounting (*i.e.*, six remaining years). Alternatively, Y may combine or net the negative $3,000 adjustment with the positive $10,000 section 481(a) adjustment required by this section, and include the resulting $7,000 amount in taxable income ratably over four consecutive taxable years, beginning with 1987. Y is not allowed to take the entire unamortized amount of the prior section 481(a) adjustment into account for its 1987 taxable year.

(h) *Procedures for change in method of accounting*—(1) *Applicability.* Paragraph (h) of this section applies to taxpayers who change from the cash method as required by this section. Paragraph (h) of this section does not apply to a

change in accounting method required by any Code section (or regulations thereunder) other than this section.

(2) *Automatic rule for changes to an overall accrual method*—(i) *Timely changes in method of accounting.* Notwithstanding any other available procedures to change to the accrual method of accounting, a taxpayer to whom paragraph (h) of this section applies who desires to make a change to an overall accrual method for its first section 448 year must make that change under the provisions of this paragraph (h)(2). A taxpayer changing to an overall accrual method under this paragraph (h)(2) must file a current Form 3115 by the time prescribed in paragraph (h)(2)(ii). In addition, the taxpayer must set forth on a statement accompanying the Form 3115 the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. Moreover, the taxpayer must type or legibly print the following statement at the top of page 1 of the Form 3115: ''Automatic Change to Accrual Method—Section 448.'' The consent of the Commissioner to the change in method of accounting is granted to taxpayers who change to an overall accrual method under this paragraph (h)(2). See paragraph (g)(2)(i), (g)(2)(ii), or (g)(3) of this section, whichever is applicable, for rules to account for the section 481(a) adjustment.

(ii) *Time and manner for filing Form 3115*—(A) *In general.* Except as provided in paragraph (h)(2)(ii)(B) of this section, the Form 3115 required by paragraph (h)(2)(i) must be filed no later than the due date (determined with regard to extensions) of the taxpayer's federal income tax return for the first section 448 year and must be attached to that return.

(B) *Extension of filing deadline.* Notwithstanding paragraph (h)(2)(ii)(A) of this section, the filing of the Form 3115 required by paragraph (h)(2)(i) shall not be considered late if such Form 3115 is attached to a timely filed amended income tax return for the first section 448 year, provided that—

(*1*) The taxpayer's first section 448 year is a taxable year that begins (or, pursuant to §1.441–2(c), is deemed to begin) in 1987, 1988, 1989, or 1990,

(*2*) The taxpayer has not been contacted for examination, is not before appeals, and is not before a federal court with respect to an income tax issue (each as defined in applicable administrative pronouncements), unless the taxpayer also complies with any requirements for approval in those applicable administrative pronouncements, and

(*3*) Any amended return required by this paragraph (h)(2)(ii)(B) is filed on or before July 8, 1991.

Filing an amended return under this paragraph (h)(2)(ii)(B) does not extend the time for making any other election. Thus, for example, taxpayers that comply with this section by filing an amended return pursuant to this paragraph (h)(2)(ii)(B) may not elect out of section 448 pursuant to paragraph (i)(2) of this section.

(3) *Changes to a method other than overall accrual method*—(i) *In general.* A taxpayer to whom paragraph (h) of this section applies who desires to change to a special method of accounting must make that change under the provisions of this paragraph (h)(3), except to the extent other special procedures have been promulgated regarding the special method of accounting. Such a taxpayer includes taxpayers who change to both an accrual method of accounting and a special method of accounting such as a long-term contract method. In order to change an accounting method under this paragraph (h)(3), a taxpayer must submit an application for change in accounting method under the applicable administrative procedures in effect at the time of change, including the applicable procedures regarding the time and place of filing the application for change in method. Moreover, a taxpayer who changes an accounting method under this paragraph (h)(3) must type or legibly print the following statement on the top of page 1 of Form 3115: ''Change to a Special Method of Accounting—Section 448.'' The filing of a Form 3115 by any taxpayer requesting a change of method of accounting under this paragraph (h)(3) for its taxable year beginning in 1987 will not be considered late if the form is filed with the appropriate office of the Internal Revenue Service on or before the later of: the date that is the

180th day of the taxable year of change; or September 14, 1987. If the Commissioner approves the taxpayer's application for change in method of accounting, the timing of the adjustment required under section 481 (a), if applicable, will be determined under the provisions of paragraph (g)(2)(i), (g)(2)(ii), or (g)(3) of this section, whichever is applicable. If the Commissioner denies the taxpayer's application for change in accounting method, or if the taxpayer's application is untimely, the taxpayer must change to an overall accrual method of accounting under the provisions of either paragraph (h)(2) or (h)(4) of this section, whichever is applicable.

(ii) *Extension of filing deadline.* Notwithstanding paragraph (h)(3)(i) of this section, if the events or circumstances which under section 448 disqualify a taxpayer from using the cash method occur after the time prescribed under applicable procedures for filing the Form 3115, the filing of such form shall not be considered late if such form is filed on or before 30 days after the close of the taxable year.

(4) *Untimely change in method of accounting to comply with this section.* Unless a taxpayer to whom paragraph (h) of this section applies complies with the provisions of paragraph (h)(2) or (h)(3) of this section for its first section 448 year, the taxpayer must comply with the requirements of §1.446–1 (e)(3) (including any applicable administrative procedure that is prescribed thereunder after January 7, 1991 specifically for purposes of complying with this section) in order to secure the consent of the Commissioner to change to a method of accounting that is in compliance with the provisions of this section. The taxpayer shall be subject to any terms and conditions (including the year of change) as may be imposed by the Commissioner.

(i) *Effective date*—(1) *In general.* Except as provided in paragraph (i)(2), (3), and (4) of this section, this section applies to any taxable year beginning after December 31, 1986.

(2) *Election out of section 448*—(i) *In general.* A taxpayer may elect not to have this section apply to any (A) transaction with a related party (within the meaning of section 267(b) of the Internal Revenue Code of 1954, as in effect on October 21, 1986), (B) loan, or (C) lease, if such transaction, loan, or lease was entered into on or before September 25, 1985. Any such election described in the preceding sentence may be made separately with respect to each transaction, loan, or lease. For rules relating to the making of such election, see §301.9100–7T (temporary regulations relating to elections under the Tax Reform Act of 1986). Notwithstanding the provisions of this paragraph (i)(2), the gross receipts attributable to a transaction, loan, or lease described in this paragraph (i)(2) shall be taken into account for purposes of the $5,000,000 gross receipts test described in paragraph (f) of this section.

(ii) *Special rules for loans.* If the taxpayer makes an election under paragraph (i)(2)(i) of this section with respect to a loan entered into on or before September 25, 1985, the election shall apply only with respect to amounts that are attributable to the loan balance outstanding on September 25, 1985. The election shall not apply to any amounts advanced or lent after September 25, 1985, regardless of whether the loan agreement was entered into on or before such date. Moreover, any payments made on outstanding loan balances after September 25, 1985, shall be deemed to first extinguish loan balances outstanding on September 25, 1985, regardless of any contrary treatment of such loan payments by the borrower and lender.

(3) *Certain contracts entered into before September 25, 1985.* This section does not apply to a contract for the acquisition or transfer of real property or a contract for services related to the acquisition or development of real property if—

(i) The contract was entered into before September 25, 1985; and

(ii) The sole element of the contract which was not performed as of September 25, 1985, was payment for such property or services.

(4) *Transitional rule for paragraphs (g) and (h) of this section.* To the extent the provisions of paragraphs (g) and (h) of this section were not reflected in paragraphs (g) and (h) of §1.448–1T (as set forth in 26 CFR part 1 as revised on April 1, 1993), paragraphs (g) and (h) of

this section will not be adversely applied to a taxpayer with respect to transactions entered into before December 27, 1993.

[T.D. 8514, 58 FR 68299, Dec. 27, 1993, as amended by T.D. 8996, 67 FR 35012, May 17, 2002]

§ 1.448–1T Limitation on the use of the cash receipts and disbursements method of accounting (temporary).

(a) *Limitation on accounting method*—(1) *In general.* This section prescribes regulations under section 448 relating to the limitation on the use of the cash receipts and disbursements method of accounting (the cash method) by certain taxpayers.

(2) *Limitation rule.* Except as otherwise provided in this section, the computation of taxable income using the cash method is prohibited in the case of a—

(i) C corporation,

(ii) Partnership with a C corporation as a partner, or

(iii) Tax shelter.

A partnership is described in paragraph (a)(2)(ii) of this section, if the partnership has a C corporation as a partner at any time during the partnership's taxable year beginning after December 31, 1986.

(3) *Meaning of C corporation.* For purposes of this section, the term ''C corporation'' includes any corporation that is not an S corporation. For example, a regulated investment company (as defined in section 851) or a real estate investment trust (as defined in section 856) is a C corporation for purposes of this section. In addition, a trust subject to tax under section 511 (b) shall be treated, for purposes of this section, as a C corporation, but only with respect to the portion of its activities that constitute an unrelated trade or business. Similarly, for purposes of this section, a corporation that is exempt from federal income taxes under section 501 (a) shall be treated as a C corporation only with respect to the portion of its activities that constitute an unrelated trade or business. Moreover, for purposes of determining whether a partnership has a C corporation as a partner, any partnership described in paragraph (a)(2)(ii) of this section is treated as a C corporation. Thus, if partnership ABC has a partner that is a partnership with a C corporation, then, for purposes of this section, partnership ABC is treated as a partnership with a C corporation partner.

(4) *Treatment of a combination of methods.* For purposes of this section, the use of a method of accounting that records some, but not all, items on the cash method shall be considered the use of the cash method. Thus, a C corporation that uses a combination of accounting methods including the use of the cash method is subject to this section.

(b) *Tax shelter defined*—(1) *In general.* For purposes of this section, the term ''tax shelter'' means any—

(i) Enterprise (other than a C corporation) if at any time (including taxable years beginning before January 1, 1987) interests in such enterprise have been offered for sale in any offering required to be registered with any federal or state agency having the authority to regulate the offering of securities for sale,

(ii) Syndicate (within the meaning of paragraph (b)(3) of this section), or

(iii) Tax shelter within the meaning of section 6661 (b)(2)(C)(ii) (relating to (A) a partnership or other entity, (B) any investment plan or arrangement, or (C) any other plan or arrangement, whose principal purpose is the avoidance or evasion of Federal income tax).

(2) *Requirement of registration.* For purposes of paragraph (b)(1)(i) of this section, an offering is required to be registered with a federal or state agency if, under the applicable federal or state law, failure to register the offering would result in a violation of the applicable federal or state law (regardless of whether the offering is in fact registered). In addition, an offering is required to be registered with a federal or state agency if, under the applicable federal or state law, failure to file a notice of exemption from registration would result in a violation of the applicable federal or state law (regardless of whether the notice is in fact filed).

(3) *Meaning of syndicate.* For purposes of paragraph (b)(1)(ii) of this section, the term ''syndicate'' means a partnership or other entity (other than a C corporation) if more than 35 percent of